

Message Text

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PAGE 01 PARIS 21028 022135Z

72

ACTION EUR-25

INFO OCT-01 EA-11 ADP-00 AGR-20 CEA-02 CIAE-00 COME-00

DODE-00 EB-11 FRB-02 H-03 INR-10 INT-08 L-03 LAB-06

NSAE-00 NSC-10 PA-03 RSC-01 AID-20 CIEP-02 SS-15

STR-08 TAR-02 TRSE-00 USIA-15 PRS-01 OMB-01 RSR-01

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AMEMBASSY LONDON

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TAGS: EFIN, FR

SUBJECT: DOES UPWARD FLOAT OF FRANC THREATEN RECESSION IN FRANCE?

1. SUMMARY: HIGHLY PLACED FRENCH OFFICIALS HAVE BEEN SIGNALING TO US PRIVATELY GROWING CONCERN ABOUT POSSIBLE ADVERSE EFFECTS OF RECENT UPWARD FLOAT OF FRANC AGAINST DOLLAR ON FRENCH EXPORTS, BUSINESS ACTIVITY AND EMPLOYMENT, LEADING TO RECESSION AND POSSIBLY TO SERIOUS DETERIORATION FRENCH POLITICAL CLIMATE. WHILE FULLY CONSCIOUS OF LIMITATIONS OF ECONOMIC FORECASTING, WE FIND NO EVIDENCE EITHER IN FRENCH OFFICIAL OR OECD PROJECTIONS OF FRENCH ECONOMIC EVOLUTION OR IN SURVEYS OF FRENCH BUSINESS OPINION, TO SUBSTANTIATE THESE FEARS. WE ARE INCLINED TO THINK THAT FRENCH

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PAGE 02 PARIS 21028 022135Z

WORRIES ARE AT LEAST PARTLY ROOTED IN UNCERTAINTIES ABOUT HOW

WELL FRENCH ECONOMY WILL ADJUST TO SITUATION WHERE FRANC IS NO LONGER UNDERVALUED VIS-A-VIS DOLLAR, STERLING AND NUMBER OF OTHER CURRENCIES. IN ANY CASE, THIS WEEK'S STRENGTHENING OF DOLLAR IN EXCHANGE MARKETS SHOULD HELP ASSUAGE FRENCH APPREHENSIONS. END SUMMARY.

2. WITHIN PAST WEEK THREE HIGHLY PLACED FRENCH OFFICIALS - ECONOMICS AND FINANCE MINISTER GISCARD D'ESTAING (PARIS 20620), LABOR MINISTER GORSE (PARIS 20691) AND ELYSEE SECRETARY GENERAL BALLADUR - HAVE PRIVATELY SIGNED TO US GROWING CONCERN OF FRENCH GOVT ABOUT WHAT THEY FEAR COULD BE ADVERSE EFFECTS OF DOLLAR DEPRECIATION OVER LAST THREE MONTHS, ON FRENCH EXPORTS, BUSINESS ACTIVITY AND EMPLOYMENT. IN RADIO INTERVIEW ON JULY 25 GISCARD PUBLICLY SOUNDED SIMILAR NOTE, WHEN HE SAID FRANC OVERVALUATION RELATIVE TO DOLLAR WOULD "DRIVE FROM MARKET" PRODUCTS OF SUCH KEY FRENCH INDUSTRIES AS AIRCRAFT, INDUSTRIAL MACHINERY, ELECTRICAL EQUIPMENT AND TIRES (PARIS 20566). WHILE DEGREE OF CONCERN EXPRESSED HAS VARIED -- GORSE, FOR EXAMPLE, ACTUALLY USED TERM "RECESSION" - ALL THREE OFFICIALS RAISED SAME SPECTER: RISE OF UNEMPLOYMENT IN FRANCE - AND ELSEWHERE IN EUROPE AS WELL - THROUGH INABILITY OF FRENCH (AND OTHER EUROPEAN) EXPORTERS TO COMPETE EITHER IN US MARKET OR IN THIRD MARKETS AS A RESULT OF WHAT THEY LABEL THE UNDERVALUED DOLLAR. THEY SEEM TO FEAR THAT RECESSION AND SPREADING UNEMPLOYMENT COULD LEAD TO LABOR UNREST AND POSSIBLY TO A SERIOUS DETERIORATION OF FRENCH AND EUROPEAN POLITICAL CLIMATE. MORAL WHICH THEY DRAW IS THE NOW FAMILIAR EXHORTATION TO US TO INTERVENE ON EXCHANGE MARKETS WITH OBJECTIVE OF ARRESTING FURTHER DECLINE IN DOLLAR RATE AND HOPEFULLY EFFECTING SOME RECOVERY TOWARDS LEVEL RESULTING FROM FEBRUARY DEVALUATION, ALTHOUGH NOT NECESSARILY ALL THE WAY BACK TO THAT LEVEL AT PRESENT JUNCTURE.

3. WE SEE LITTLE EVIDENCE OF EITHER PRESENT OR NEAR-TERM SLACKENING IN OVER-ALL LEVELS OF OUTPUT AND EMPLOYMENT. CURRENT STATE OF FRENCH ECONOMY IS ONE OF NEARLY FULL EMPLOYMENT, IF NOT OVERHEATING. LEVELS OF PRODUCTION IN SEVERAL BRANCHES OF INDUSTRY ARE PRESSING AGAINST LIMITS OF CAPACITY. NATIONAL PRODUCT IS PROJECTED TO RISE IN CURRENT YEAR BY ROUGHLY 6 PERCENT IN REAL TERMS. INFLATION CONTINUES AT EXCEEDINGLY FAST PACE. CONSUMER PRICES ARE ADVANCING AT ANNUAL RATE OF 8.5 OR 9 PERCENT, WITH NO LIMITED OFFICIAL USE

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SLOW DOWN FORESEEN, AND HOURLY WAGES AT ANNUAL RATE OF 13 OR 14 PERCENT. EXTERNAL TRADE FOR FIRST HALF YEAR SHOW MODERATE SURPLUS, AND EXPECTATION IS WIDESPREAD THAT THIS STATE OF AFFAIRS WILL PREVAIL THROUGHOUT SECOND HALF. MAIN DANGER FOR FRENCH ECONOMY AT PRESENT IS THAT EXTREMELY RAPID GROWTH MAY REQUIRE OVERLY SHARP CORRECTION.

4. THE FIRST PROJECTS OF FRENCH ECONOMIC PERFORMANCE IN 1974

SUGGEST NO RADICAL CHANGES FROM THE 1973 PATTERN. FRENCH OFFICIAL SPRING NATIONAL ACCOUNTS FORECASTS DO POINT TOWARDS SOME MODERATION IN GROWTH RATE IN 1974, BUT STILL PROJECT A HEALTHY 5.6 PERCENT. RATE OF GROWTH OF EXPORTS BY VOLUME IS ALSO DOWN ONE POINT FROM 12 PERCENT FIGURE FOR 1973, BUT TRADE ACCOUNT WOULD STILL BE IN SURPLUS. OECD SEMI-ANNUAL ECONOMIC REVIEW, RELEASED IN MID-JULY, PROJECTS CONTINUED ECONOMIC EXPANSION IN FRANCE AT AROUND 6 PERCENT ANNUAL RATE IN FIRST HALF OF NEXT YEAR, WITH EXPORT SURPLUS ACTUALLY RISING ABOVE 1973 LEVEL. UNFORTUNATELY, THERE IS SOME TIME LAG BETWEEN PREPARATION OF THESE FORECASTS AND THEIR PUBLICATION, AND IT HAS TO BE RECOGNIZED THAT FOR MOST PART THEY PROBABLY WERE COMPLETED BEFORE FRANC AND OTHER JOINT-FLOAT CURRENCIES REACHED THEIR JULY HIGH POINT AGAINST DOLLAR. ALL THE SAME, CURRENCY FLOAT HAS BEEN GOING ON SINCE MID-MARCH, AND DURING MAY TENDENCY FOR EUROPEAN CURRENCIES TO MOVE UPWARD HAD ALREADY MANIFESTED ITSELF FOR BRIEF TIME.

5. THE PERIODIC SURVEYS OF EXPECTATIONS OF FRENCH BUSINESS LEADERS, CONDUCTED BY GOVERNMENT AND BANK OF FRANCE, HAVE RECENTLY NOTED SOME DIFFICULTIES FOR FRENCH EXPORTS IN THE AMERICAN - AND BRITISH AND ITALIAN - MARKETS. TO DATE, HOWEVER, THERE HAS BEEN NOT EVEN A HINT OF CONCERN ABOUT RECESSION IN FRANCE, WHETHER BROUGHT ON BY DECLINE IN COMPETITIVE POSITION OF FRENCH EXPORT INDUSTRIES OR BY ANY OTHER CAUSE. IN FACT, LATEST BUSINESS SURVEY, TAKEN IN JULY, NOTES THAT FOREIGN DEMAND IS VERY ACTIVE AND THAT UNFILLED FOREIGN ORDERS ARE VERY HIGH. SURVEY FINDS THAT WHILE BUSINESSMEN EXPECT A CERTAIN SLOWDOWN IN THE FALL FROM EXTREMELY RAPID GROWTH OBSERVED SO FAR IN 1973, THIS IS LARGELY DUE TO LACK OF ADDITIONAL UNUSED CAPACITY. PRESENT BUSINESS MOOD CONTRAST WITH WIDESPREAD PESSIMISM IN LATTER HALF OF 1971 THAT MONETARY UNCERTAINTIES WOULD SOMEHOW PROVOKE ECONOMIC DOWNTURN IN FRANCE AND ELSEWHERE.

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6. UNDOUBTEDLY, IF DOLLAR WERE TO REMAIN IN NEIGHBORHOOD OF 4 FRANCS FOR EXTENDED PERIOD, SOME INDIVIDUAL FRENCH FIRMS, AND PERHAPS SOME BRANCHES OF FRENCH INDUSTRY, WOULD FEEL PINCH IN TERMS OF THEIR INTERNATIONAL COMPETITIVE POSITION, IN THIS RESPECT, A SPECIAL WORD NEEDS TO BE SAID ABOUT FRENCH AIRCRAFT INDUSTRY. LONG BEFORE RECENT UPWARD FLOAT OF FRANC AGAINST DOLLAR. THAT INDUSTRY WAS IN THE DOLDRUMS, BOTH BECAUSE OF INTERNAL DIFFICULTIES AND BECAUSE OF DEPRESSED STATE OF INTERNATIONAL MARKET FOR AIRCRAFT. NOR WOULD ITS TROUBLES BE ENDED BY RETURN OF FRANC-DOLLAR EXCHANGE RATE TO 4.60 RANGE.

7. IN CONCLUSION, WHILE FULLY CONSCIOUS OF LIMITATIONS SURROUNDING ECONOMIC FORECASTING AND PROBLEM OF TIME LAG IN MATERIAL NOW AVAILABLE, WE FIND NO EVIDENCE TO SUBSTANTIATE THE

PROPOSITION THAT FRENCH ECONOMY STANDS IN DANGER OF RECESSION
PROVOKED BY AN OVERVALUED CURRENCY. WE ARE INCLINED TO THE VIEW
THAT FRENCH CONCERNS ON THIS SCORE ARE MORE VISCERAL THAN
REASONED. THEY HAVE A LONG-STANDING
POLICY OF MAINTAINING AN UNDERVALUED CURRENCY SO AS TO ENSURE
THE GOOD EXPORT PERFORMANCE, PAYMENTS SURPLUSES AND STRONG
FRANC WHICH THEY BELIEVE NECESSARY TO BOTH THEIR INTERNAL AND
EXTERNAL ECONOMIC AND POLITICAL OBJECTIVES. WHILE FRANC REMAINS
UNDERVALUED VIS-A-VIS DEUTSCHEMARK, RATE ADJUSTMENTS OVER PAST
TWO YEARS HAVE ENDED ITS UNDERVALUATION AGAINST DOLLAR, STERLING
AND A NUMBER OF OTHER CURRENCIES. NO DOUBT FRENCH ARE CONCERNED
ABOUT POSSIBLE DISLOCATIONS THAT ADJUSTMENT OF FRENCH ECONOMY TO
THIS STATE OF AFFAIRS COULD ENGENDER. AS IS OFTEN THE CASE WHEN
THEY GET INTO SUCH A FRAME OF MIND, THEY SEEM TO HAVE DRAMATIZED THE
SITUATION BEYOND WHAT UNDERLYING FACTORS WOULD WARRANT. IN
ANY CASE, THIS WEEK'S STRENGTHENING OF DOLLAR SHOULD CERTAINLY HELP
TO PUT MATTER INTO BETTER PERSPECTIVE IN FRENCH THINKING AND
ATTITUDES.
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